No. 288.

IN THE

UNITED STATES

CIRCUIT COURT OF APPEALS

FOR THE

NINTH CIRCUIT.

THE FARMERS' LOAN & TRUST COMPANY, *Appellant*,

vs.

PETER G. LONGWORTH, MICHAEL RASKEY AND ANNIE RASKEY, HIS WIFE, AND RICHARD A. BELLINGER, *Appellees.*

Appeal from the Circuit Court of the United States, for the District of Washington, Northern Division.

Brief of Appellees on the Merits.

JAMES HAMILTON LEWIS,
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ORMAN & HANFORD STATIONERY & PRINTING CO., SEATTLE.

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BRIEF OF APPELLEES ON THE MERITS.

As will be apparent to the court, any elaborate discussion of this question in the abstract can add nothing to the force of the position asserted. But if well taken, it is so because of an established equity, and not because of any philosophy or comparison of respective views of different courts pro or con.

I.

As seen by the record and the briefs, this is a cause where the court allowed the claims of the appellees and

gave them preference to the mortgage, exercising that right within the equity power of the court. Like all advanced ideas of equity and new theories moulded into practice by the necessity of the institutions and the customs of affairs; this peculiar equity has had to move gradually, by being accepted by the court upon the reason of each particular case and the circumstances surrounding each particular case. The equities attaching to it, the burdens borne by all parties, the privileges which one is seeking over the other, the vast or limited advantage which a mortgagee may have by holding the property, the greater or less embarrassment or wrong there may appear to be done to the claims by the mortgagee taking possession of the property,—all of these go into the consideration of an equity court in order to reach the conclusion when it is equitable to attach to the privilege of the mortgagee in taking possession of the property certain burdens and limitations. In each of these cases the court is quite the sole judge. It is the exercise of the equity discretion which in nearly all cases must be left to the court to be drawn from the conditions surrounding it, and must necessarily be left uninterfered with in ordinary instances certainly, lest we wholly destroy what the word "discretion" in equity is meant to confer and convey.

II.

It must be conceded, notwithstanding some circuit court rulings, that the highest courts of this country have announced the doctrine respecting railroads, that where a mortgagee takes a mortgage upon such he does it with a consciousness of all existing liens and burdens surrounding such a contract, and assumes by reason of

such knowledge to contract in special reference to such privileges as a court of equity may have in treating claims which ordinarily arise in the operation of a railroad, and also to have attached as a burden or limitation to his exclusive privilege in taking charge of the property upon a mere default of interest, the burden of discharging certain claims which would have been paid through legal process had the morgagee not assumed such peculiar prerogative and sought the court to enforce it, to-wit: the taking the full charge and control, before foreclosure or decree, of the property.

With this contract and privilege as a part of his undertaking, it is but natural that he should accept its exercise at any time where the circumstances justify the exercise of that discretion. It is now the recognized privilege of a court, to use the exact words of the law, that is to say:

"When a court of chancery appoints a receiver of "railroad property, it may impose such terms in refer- "ence to the payment from the income, during the re- "ceivership, of outstanding debts for labor, supplies, "equipment or permanent improvement, *or other charges* "*upon the property as may under the circumstances of* "*the particular case appear to be reasonable.*"

Fosdick vs. Schall, 99 U. S., 235.
Mittenberger vs. Logansport Ry., 106 U. S., 286.
Union Trust Co. vs. Souther, 107 U. S., 591.
Union Trust Co. vs. Midland Ry., 117 U. S., 434.
Thomas vs. Peoria R. R., 26 Am. & Eng. Ry. Cases, 381.

Addison vs. Lewis, Receiver, etc., 9 Am. & Eng. Ry. Cases, 702; S. C., 75 Va., 701.

20 Am. & Eng. Enc. of Law, p. 417 (§3); p. 426 (§3), et seq.

19 Am. & Eng. Enc. of Law, p. 758.

III.

It appears in this case that at the time of the appointment of the receiver the order for these preferences and for the payment of these claims was not made, but immediately thereafter upon the matter being called to the court's attention by petition, to-wit: that the claims were outstanding, that receiver's certificates had been ordered to pay the claims, that judgment had been duly obtained, etc., *and upon the further petition stating that the company had in its possession, by its report, and the receiver then held more than enough money to pay its interest and still have a surplus sufficient to pay these claims.*

(See paragraph 6 of Petition for Payment, Transcript, page 4.)

This paragraph not denied by the company defendant nor the appellant trust company; but, as must govern this court, all the way through such allegations stand admitted as facts; and upon this alone, excluding every other consideration in this case, the court had a right to make this order against the receiver. It was as though made against a fund which was in excess of debts.

Therefore, at any time subsequent to the appointment of a receiver within the wise discretion of the court it had a right to make the order made in this cause. This

is certainly the advance doctrine and the recognized doctrine stated in the words of the law:

"If no such provision [that is, provision to pay the "claims previously existing] be made in the order ap- "pointing the receiver, a court of equity may at any "time during the progress of the cause direct the pay- "ment."

Fosdick vs. Schall, 99 U. S., 235.
Poland vs. R. R. Co., 52 Vt., 144.
Farmers' L. & T. Co. vs. Vicksburg Road, 33 Fed., 777.
19 Am. and Eng. Enc. of Law, pp. 758-9.

IV.

Particularly is this true when, as the record here discloses, the mortgagee after default in the interest "is suffered to remain in possession and incur these debts in operating the road, and the mortgagees cannot take possession of the property through receivers and assert their mortgage in preference to *these expenses of operating*, especially if the mortgage itself provide that the mortgagee might remain in possession, operating the road and paying its current expenses."

Williamson vs. Washington City Road, 1 Am. and Eng. Ry. Cases, 489.
Turner vs. Indianapolis Road, 8 Bissell, 315.
Lehigh R. R. Co. vs. Central R. R. Co., 34 N. J. Eq., 88.
Poland vs. R. R., 4 Am. & Eng. Ry. Cases, 410. S. C., 52 Vt., 144.
19 Am. & Eng. Enc. of Law, p. 758-9.

V.

But it appears also from the undenied petition, and from the uncontroverted facts, that "the current earnings of the road had been previously used by the mortgagee for the payment of its interest, while the same should have been applied to the expenses of the operation; and under such circumstances it is the right of the court at any time in the exercise of its equity jurisdiction to charge against the property the restoration of this fund to any extent which the fund may not exceed, and order that the manner of this restoration shall be by the payment of certain designated claims.

Trust Co. vs. N. Y., etc., 25 Fed., 800.
Burnham vs. Bowen, 111 U. S., 776.
(17 Am. & Eng. Ry. Cases, 308.)
Fosdick vs. Schall, 99 U. S., 233.
Huidekoper vs. Locomotive Works, 99 U. S., 258.
Addison vs. Lewis, 75 Va., 701.

The true rule being that if the earnings are deferred to the payment of interest, or to any other matter not properly operating expenses, they must be returned to the current earnings fund and may be applied to the payment of the claims made payable therefrom.

Illinois Midland R. R. Co. vs. Trust Co., 117 U. S., 434.
Trust Co. vs. Morrison, 125 U.S., 591.
Railroad vs. Cleveland et al., 125 U. S., 658.
Wood vs. Company, 128 U. S., 416.
Easton vs. Road, 38 Fed., 12.
Trust Co. vs. Road, 33 Fed., 778.
Calhoun vs. Road, 9 Bissell, 330.

VI.

But of late, notwithstanding some intimations of the circuit to the contrary, the Supreme Court of the United States have particularly held that claims such as these before the court were proper subjects of preference, and proper subjects of just such order as is complained of here, particularly where the long-standing of the claims and their nature were such that in the exercise of an equity discretion it would be but just to order the payment from the mortgagee who had permitted the road to remain in the hands of the mortgagor, being run and incurring these expenses in the operation of the road, and waiting until after the claims had passed to judgment and from judgment into an order, and then in no wise denying the priority or justness of the claims, seek to absorb the whole of the property to the subordination of the claims.

We invite particular attention to the opinion of the learned court below in this cause; also to the copious decision where Chief Justice Waite first urges this equity in

Fosdick vs. Schall, heretofore cited,

and the further recognition of just such claims in the case of

Trust Co. vs. Midland R. R. Co., 117 U. S., 434,

the decision proceeding, among other things, to say:

"After the first mortgagee had appeared and answered "an order was made, *but not on prior notice to it*, au- "thorizing the receiver to issue certificates," etc.

To these priority is given. In this case the court has occasion to discuss the feature, which is made an item

by the appellant, that it had no notice of the hearing in this case; that such was not necessary, and if necessary when it came it had all the notice then that the court would exact. And proceeding upon the merits of the order which the court had made, allowing preferences, the court says, in reply to the contention that such could not be allowed:

"It cannot be affirmed that no items which accrued "before the appointment of a receiver can be allowed in "any case. Many circumstances may exist which may "make it necessary and indispensable to the business of "the road and the preservation of the property, for the "receiver to pay pre-existing debts of certain classes, out "of the earnings of the receivership, or even the *corpus* of "the property, under the order of the court, with a prior- "ity of lien. Yet the discretion to do so should be exer- "cised with very great care. The payment of such debts "stands, *prima facie*, on a different basis from the pay- "ment of claims arising under the receivership, while it "may be brought within the principle of the latter by "special circumstances. It is easy to see that the pay- "ment of unpaid debts for operating expenses, accrued "within ninety days, due by a railroad company sud- "denly deprived of the control of its property, due to op- "eratives in its employ, whose cessation from work sim- "ultaneously is to be deprecated, the interests both of the "property and of the public, and the payment of limited "amounts due to other and connecting lines of road for "materials and repairs, and for unpaid ticket and freight "balances, the outcome of indispensable business rela- "tions, where the stoppage of the continuance of such "business relations would be a probable result in case of

"non-payment, the general consequences involving "largely, also, the interests and accommodation of travel "and traffic, may well place such payments in the cate- "gory of payments to preserve the mortgaged property "in a large sense, by maintaining the good-will and in- "tegrity of the enterprise, and entitle them to be made "a first lien."

And it will be observed in that same decision that many of the items and things referred to as the proper subject of such prior claim, we find the following stated by the court:

"The strenuous contention on the part of the Paris "and Decatur bondholders is that a court of chancery "had no power, by a receiver and without their consent, "to create, on the *corpus* of the property, any lien taking "priority over the mortgage lien. But these bond- "holders were represented by their trustees, the Union "Trust Company. It filed a bill in the federal court as "early as December, 1876, to foreclose the Paris and "Decatur mortgage; and it was made a party on its own "petition, to the suit in the state court, in September, "1877. The Paris and Decatur mortgage provided that "in case of default for six months in paying interest on "the bonds (and such default occurred at latest on Jan- "uary 1, 1876, and the six months expired July 1, 1876, "more than three months before any order was made "on which any of the certificates were issued), all the "bonds should become due and the lien might be en- "forced, and the trustees might enter on the property "and operate it till sold, and make all needful repairs "and replacements, and such useful alterations, addi- "tions and improvements to the road as might be neces-

"sary for its proper working, and pay for them out of "the income; and also that in case of default so continu- "ing, the trustee might foreclose the mortgage by legal "proceedings or sell the property by public auction; "and should, in case of such sale, deduct from the pro- "ceeds all expenses incurred in operating, managing or "maintaining the road or in managing its business, and "thereafter apply the proceeds to pay the bonds. In "the face of these provisions of the mortgage under "which the bonds are held, and of the facts before re- "cited as to the negligence of the trustee all the while "the property was in the hands of the court, it does not "at all comport with the principles of equity for the "bondholders now to insist that the want of affirmative "consent by them or their trustee could paralyze the "arm of the court in the discharge of its duty. The "want of that aid which it was the duty of the trustee "and the bondholders to give to the court in discharg- "ing its responsible functions, with the road openly in "charge of the receiver and being run by him, and his "acts plain to view, and the interest of all the bonds in "arrear, cannot be urged to a court of equity as a "ground for denying its power to do what was thought "by it best for the interests of all concerned, including "even those who thus willfully stood aloof.

"The appellants Borge and others also complain of "provisions in the final decree, giving priority over the "Paris and Decatur bonds to just and equitable propor- "tions of the following items: 1, amount of wages due "employes of receivers, Dole, Reese and Genis, as "shown by schedules J and K of the report of the com- "missioner, the total amount being $76,820.90; 2, the

"indebtedness due from the receivership to railroad "companies, as shown by schedule L of the report, "amounting to $84,615.21; 3, the general indebtedness "of the receivership, as shown by schedule M of the "report, under the head of supplies, amounting to "$67,787.76, and under the *head of* '*damages*,' amount- "ing to $5,871.04, and forty-four items under the head "of 'miscellaneous,' amounting to $32,937.49; * * * "5, four claims on intervening petitions, allowed at "$11,642.29; 6, amount of wages due employes of the "Illinois Midland Company within six months imme- "diately preceding the appointment of the first receiver, "as shown by schedule H of the report; such equitable "portions of the receiver's indebtedness and of the six "months' labor claims to be ascertained in the manner "provided by the decree."

To which the court further says:

"The claims embraced in the six items have been "carefully scrutinized and reported on favorably by the "commissioner, and allowed by the Circuit Court, "within and in accordance with the principles above laid "down, and we think that all of them, including the "'six months' labor claims,' were properly allowed."

And this contention and the recognition of this equity and this discussion on the part of the court, while we see various views in various districts, each judge following the views applicable in his particular circuit, still the trend of the cases on the basis of reason and equity are in harmony with this view and sustain it, as will be seen by a reference to the cases themselves, first referring to the cases mostly relied on by appellant:

Kneeland vs. Trust Co., 136 U. S., 89,

recognizing the doctrine of

Hale vs. Frost, 99 U. S., 389.
Barton vs. Barbour, 104 U. S., 126.
Trust Co. vs. Souther, 107 U. S., 591.
Burnham vs. Bowen, 111 U. S., 776.

In the last case cited the court say:

"The receivership was at the instance of a judgment "creditor, and was with a view of reaching the surplus "earnings for the satisfaction of his debt."

And *referring particularly to this Kneeland* case showing why it is an exception to the cases heretofore cited to the court, of railroad companies where the mortgagees take possession against which there is had such conditions as an equity court has a right to impose, the court continuing says:

"It [meaning the receivership in that particular case] "*was not at the instance of the mortgagees, nor were* "*they seeking foreclosure of their mortgages.* They "were asking nothing at the hands of the court. They "were not asking it to take charge of the property."

Here is the distinction.

In the case now before the court for consideration, the mortgagee did seek foreclosure, does ask the court to take charge of the property for it, and was asking something at the hands of the court as a privilege. It was to this privilege the court had a right to attach the equitable burden which in its discretion it has so done. This order is made against the receiver and against the property, because of the management by the court of

the property and the exclusion of all creditors; and we insist that the following words of the court showing that the court appointing the receiver has a right to put such conditions upon that appointment, and that those conditions recognized here are the conditions which had previously been imposed and recognized by the cases heretofore cited, which and only in the line of which are again recognized and indulged in by the lower coart.

Further in the Kneeland case, therefore, (at page 383, Co-Op. Series) say the court:

"* * * When a court appoints a receiver of *rail-*
"*road property*, it has no right to make that receiver-
"ship conditional on the payment of other than those
"unsecured claims *which by the rulings of this court*
"*have been declared to have an equitable priority.*"

It will be seen that it was upon the facts of that particular case by which the exception to the rule of equity previously adopted was permitted to exist.

Now in the further case which has been the subject of discussion by the appellant, Thomas vs. Car Co., 149 U. S., 95, this was another instance of rent, and upon the facts in that case purely did the court except it from the ruling of the equity. Mr. Justice Shiras refers particularly to Miltenberger vs. Road, 106 U. S., and reaffirms that doctrine, and notesthe exception asserted and recognized in Kneeland vs. Trust Co., and they refer to the exception that in the case under consideration, say the contract between the car company and the railroad company was that the car company reserved the right to terminate its contract and take possession of

its cars; that it knew of the existence of the outstanding bonds, and protected itself wholly and solely upon the method agreed, to wit, the taking back of its particular property, not by any agreement implied or otherwise *to receive payment*. The case is therefore widely different from the one under consideration in this court, and the reasons offered there for excepting it from the rule of the new equity, heretofore urged, is palpable. (See 149 U. S. Co-Op. Series, page 113.) The court following and saying:

"This company [meaning the car company] must be "treated as having full notice of the financial condition "of the railroad, and as having leased the cars without "the expectation of displacing the priority of the mort-"gage liens."

And here again the court, referring to the lower court's decision, says:

"The court then states the general principles which "have been established by the decisions of this court as "to charging the income of the receivership with the "payment of certain classes of liabilities of the railroad "company incurred prior to the receivership, and their "payment from the proceeds of the sale of the railroad "prior to the mortgage indebtedness."

Here the Supreme Court recognizes the rule previously obtaining, and which, under proper facts, they still assert by acquiescence is existing for a court to enforce under conditions submitting it to its discretion.

These views, such as we urge, have been followed by the courts on circuit in the following cases:

Farmers' Loan & T. Co. vs. Kansas City W. N. R. R., 33 Fed., 187; opinion by Judge Caldwell. See full note with collection of cases, pages 192-3.

Hook vs. Bosworth, 64 Fed., 445.

Clark vs. Railroad, 66 Fed., 806.

Farmers' L. & T. Co. vs. N. P. R. R., on the petition of O'Brien, 71 Fed., 247.

These cases were followed by opinions by Judge Thomas and also supported by opinions of Judge Caldwell from Dakota, which I trust will be out by the time this cause is submitted to the court, wherein it was held that debts for coal contracted previous to the receivership could be attached as a prior lien. Also where it was held by Judge Caldwell, following his first decision of Dow vs. Memphis Railroad, 20 Fed., that for a smash-up of cars and wagons occurring in a collision in the operation of the road previous to the appointment of the receiver, these could be made preferred claims if in the discretion of the court the circumstances seemed to require it; and here it was held, as in the 53d Federal, that such an order attaching itself as a condition to the receivership could be made at any time.

And we insist that upon the facts of this case to the order made the mortgage company has no right to complain and should not be heard to appeal, and that by the decisions of the highest court such doctrine is asserted; and irrespective of the merits or demerits of the order of the lower court, this mortgage company has no right or standing in this court to assert any objections to it.

Masterson vs. Herndon, 10 Wall., 416.

Swan vs. Wright, 110 U. S., 590.

Williams vs. Morgan, 111 U. S., 590.

Its attitude is very much the attitude of a purchaser under a decree; the purchaser takes what is sold under the decree with all its conditions. This mortgage company takes charge of this property by its demand under and connected with such conditions as are imposed upon the receivership at the time or subsequently.

See full case,

Farmers' Loan & Trust Co. vs. K. C. W. & N. R. R., 53 Fed., 182, opinion by Justice Caldwell, page 189.

See full note by Maurice M. Cohn, pages 192 to 197.

We respectfully submit that if for any reason this case shall not be dismissed on appeal, that the judgment should be affirmed with costs to appellees.

Respectfully submitted,

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